IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX REFERENCE NO. 117 OF 1989

The Commissioner of Income-tax,)
Bombay City-III, Bombay.) ...Applicant

V/s.

M/s.Emrald Co.Ltd.,)
Shreeniwas House, Waudby Road,)
Bombay.) ...Respondent

Mr.Ashok Katangale for Applicant.
Ms.Aarti Vissanji i/b. S.J. Mehta for Respondent.

CORAM : V.C. DAGA AND
A.S. AGUIAR, JJ.

DATED : SEPTEMBER 30, 2005.

ORAL JUDGMENT (PER A.S. AGUIAR, J.) :-

. The following question of law arising out of ITA No.4924/Bom/1984 in R.A.No.2711(Bom)/1987 for the Assessment Year 1982-82, has been referred to this Court under Section 256(1) of the Income-Tax Act by the Income Tax Tribunal :-

> "Whether, on the facts and in the circumstances of the case and in law, the Tribunal is right in holding that relief u/s. 80M should be granted without deducting from the gross dividend, the

interest paid on overdraft and other expenditure incurred for the purpose of earning the dividend in view of the provisions of section 80AA read with section 80M ?"

2. The assessee is a company dealing in shares and earns income from dividends and also property. The assessee company filed its return for the Assessment Year 1981-82 on 31st July, 1981 declaring a loss of Rs.935/-. In response to notice under Section 143(2) of the Income Tax Act, the company's accountant attended before the ITO. The assessee had earned income from the business of trading in shares of Rs.16,549/- and dividend of Rs.1,34,984/- and from property of Rs.84,000/-. Company had utilised Overdraft facility for purchase of shares and had paid interest of Rs.45,469/- on the Overdraft and incurred other expenses to the tune of Rs.24,900/- which was debited to the Profit and Loss Account and taken into account for arriving at a profit of Rs.81,718/-. The ITO computed the net dividend income in accordance with the provisions of Sections 56, 57 and 58 and proceeded to

allow 60% deduction under Section 80M on the income so computed.

3. Commissioner of Income Tax (Appeals) following the Gujarat High Court decision in the case of **CIT V/s. Cotton Fabrics Ltd., 132 ITR 99** held that the assessee was a dealer in shares. Both the interest paid on the amount borrowed for the purchase of shares and other expenses incurred by the company and allocated to the dividend income were held to be allowable under the Head "Business" and not under the Head "Other Sources". He accordingly directed the ITO to allow deduction under Section 80M on the gross dividend.

4. In appeal, the Tribunal held that the assessee was admittedly a dealer in shares and the expenditure on interest on borrowings for the purchase of the shares and other expenses incurred by the assessee were allowable under the Head "Income from Business" and on the basis of the Gujarat High Court Judgment in the case of **CIT V/s. Cotton Fabrics Ltd., 132 ITR 99** held that expenses should not be deducted from the dividend income

for granting deduction under Section 80M. The Tribunal confirmed the order of the CIT (Appeals).

5. Learned Advocate for the assessee company has pointed out that the Assessing Officer has determined the income under the Head "Business" at a loss of Rs.57,735/- after allowing the entire interest and other expenses. It is pointed out that the Assessing Officer has assessed the dividend income under the Head "Other Sources" at Rs.1,34,984/-. expenses. This is evident from the fact that dividend assessed under the Head "Other sources" is the entire amount of dividend received viz. Rs.1,34,984/- without deduction of interest and other expenses. It is, therefore, contended that for the purpose of computing deduction under Section 80M, the Assessing Officer has once again deducted the entire interest of Rs.45,469/- on the Overdraft and proportionate expenses of Rs.24,900/- from the dividend income of Rs.1,34,984/-.

6. It is the submission of the learned Advocate for the Assessee that the interest paid on the Overdraft and

other expenses are related to the business of trading in shares and should have been allowed in computing income under the Head "Business". Similar expenses cannot once again be deducted from dividend income for the limited purpose of computing the deduction under Section 80M since there is no statutory provision for permitting the Assessing Officer to deduct the same expenses under two different heads of income. It is further submitted that since the income by way of dividend included in gross total income is Rs.1,34,984/-, deduction under Section 80M has to be granted with reference to the said amount of Rs.1,34,984/-.

7. It is further submitted that the case of the assessee is that he is a trader dealing in shares and therefore, he holds the shares as stock-in-trade and not as investment. The assessee realises profit and loss from trading in shares. The income earned from dividend is incidental to the business of dealing in shares. The interest paid by the dealer for borrowing funds used for purchasing shares in the course of business of trading is an expenditure incurred in the course of business

unlike an investor who may take loans for the purpose of purchasing shares as an investment and not for sale. In the present case, it is pointed out that the interest debited to Profit and Loss Account has been taken into account for arriving at trading profit which is the starting point for working out the business income. The same cannot be once again reduced from the dividend income while working out income under "Other sources".

8. The issue for consideration is whether interest paid on borrowings used for purchase of shares held as Stock-in-trade, is to be taken into account under Section 36(1)(iii) in computing the income from trading in shares under the Head "Business" and consequently, is not to be reduced from the dividend income which would result in deduction under Section 80M being allowed on the full amount of the dividend.

9. It must be borne in mind that in the case in hand, the assessee is a trader dealing specifically in shares and that his business is trading in shares. His income, therefore, from trading in shares is required to

be assessed under the head "Business" and since the shares have been purchased out of borrowed funds, the interest on such borrowings is allowable under Section 36(1)(iii) as it is incurred for the purpose of his business. Section 36(1)(iii) reads as follows :-

> 36(1) The deductions provided in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28 -
>
> (i) xxxx
> (ii) xxxx
> (iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession;
>
> Explanation - Recurring subscriptions paid periodically by shareholders or subscribers in Mutual Benefit Societies which fulfil such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of

this clause;"

. Section 28 sets out what income shall be chargeable to income tax under the Head "Profit and Gains" of business or profession.

10. Clause (iii) of Section 36(1) makes allowance in respect of interest paid on capital borrowed for the purpose of business or profession. The dividend earned on such shares is assessed under the Head "Other sources". Any expenditure incurred wholly or exclusively for the purposes of earning the dividend income is to be deducted under Section 57(iii). Section 57(iii) reads as follows :-

"57 The income chargeable under the head "Income from other sources" shall be computed after making the following deductions, namely :-

(i) xxxx
(ii) xxxx

(iii) any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income."

11. In the case of an investor, the interest paid on borrowed funds used for purchase of shares would be deducted out of the dividend income. Since the dividend income included in the gross total income would be the net dividend (gross dividend minus interest), deduction under Section 80M would be allowed thereof.

. Section 80M reads as follows :-

"(1) Where the gross total income of an assessee, being a domestic company, includes any income by way of dividends from a domestic company, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such income by way of dividends of an amount equal to -

(a) in respect of such income by way of dividends from a company formed and registered under the Companies Act, 1956 (I of 1956), after the 28th day of February, 1975, and engaged exclusively or almost exclusively in the manufacture or production of any one or more of the articles or things specified in items 2 and 3, item 4 (excluding alloy, malleable and S.G. iron castings), items 7 to 15 (both inclusive), items 17 and 18, item 23 (excluding refractories) and items 24, 26, 27 and 29 in the list in the Ninth Schedule - the whole of such income;

(b) in respect of such income by way of dividends other than the dividends referred to in clause (a) - sixty per cent. of such income."

12. In the present case, since the assessee is a trader, though dividend is separately assessable under

Section 56, it does not cease to be a business income.

. Section 56(1) reads as follows :-

> "Income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head "Income from other sources", if it is not chargeable to income-tax under any of the heads specified in section 14, items A to E.
>
> (2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following income shall be chargeable to income-tax under the head "Income from other sources", namely :-
>
> (i) dividends;"

13. Business income is broken up under the different heads only for the purpose of computing total income, but the income does not cease to be income of the

business.

14. Therefore, in the case of dealer in shares, as in the present case, the dividend retains the character of business income though assessed under Section 56(b). The interest on the borrowings is paid for the purpose of business and therefore, allowable under Section 36(1)(iii). The interest paid is not expenditure laid out or expended wholly or exclusively for the purpose of earning the dividend as required under Section 57(iii) and therefore, should not be reduced under Section 57 from the dividend income.

15. In the present case, the ITO had computed the dividend income in accordance with the provisions of Sections 56, 57 and 58 and then proceeded to allow 60% deduction under Section 80M on the income so computed. However, the CIT (Appeals) following the Gujarat High Court decision in the case of **CIT Vs. Cotton Fabrics Ltd., 132 ITR 99** held that since the assessee is a dealer in shares, both the interest paid on the amount borrowed for the purchase of the shares and other

expenses incurred by the company and allocated to dividend income were allowable under the Head "Business" and not under the Head "Other sources". He, accordingly, directed the ITO to allow deduction under Section 80M on the gross dividend. The Tribunal also following the Gujarat High Court Judgment held that the interest on borrowing for the purpose of acquiring shares and other expenses should not be deducted from the dividend income for granting deduction under Section 80M and accordingly, confirmed the order of the CIT (Appeals).

16. This Court in the case of **CIT V/s. Maganlal Chhaganlal reported in (1999) 236 ITR 456** following the ratio of the decision of the Supreme Court in the case of **Distributors (Baroda) Pvt.Ltd. V/s. Union of India & Ors. (1985) 155 ITR 120** held that deduction under Section 80M(1) of the Act has to be calculated with reference to the amount of dividend computed in accordance with the provisions of the Act and forming part of the gross total income i.e. after deducting interest on monies borrowed for earning such income and

not with reference to the full amount of dividend received by the assessee. The Calcutta High Court in **CIT V/s. National and Grindlays Bank Ltd., (1993) 202 ITR 559** had held that relevant Section 80M is admissible on the gross amount of dividend income without deducting therefrom the interest paid for earning the dividend. It appears that the decision of the Apex Court in the case of **Distributors (Baroda) Pvt.Ltd.(cited Supra)** was not brought to the notice of the Calcutta High Court and therefore, the decision of the Calcutta High Court is inconsistent with the decision of the Supreme Court in **Distributors (Baroda) Pvt.Ltd.**

17. The decision of the Supreme Court in the case of **Distributors (Baroda) Pvt.Ltd.** is distinguishable on facts as that case was limited to the question whether deduction under Section 80M was available with respect to the gross or net amount of dividend in a case where the assessee was an investment company and not a trader dealing in shares. It may be noted that the principle laid down in **Distributors (Baroda) Pvt.Ltd.** wherein the Supreme Court construed the expression "Such income by

way of dividend in Section 80M as dividend included in the gross income which would be the dividend computed in accordance with the provisions of the Act, that is, the net dividend, has been incorporated in the Act by Section 80AA which has now been omitted w.e.from 1.4.98.

18. In the case on hand, the interest on the Overdraft and the expenses are related to the business of trading in shares and ought to be allowed as computed income under the Head "Business". The said expenses cannot once again be deducted from the dividend income for the limited purpose of computing the deduction under Section 80M of the Act. There is no statutory provision requiring the Assessing Officer to deduct the same expenses under two different heads of Income. Since the income by way of dividend included in the gross total income is Rs.1,34,984/-, the deduction under Section 80M has to be granted with reference to the said amount of Rs.1,34,984/-.

19. In the light of above discussion, we uphold the decision of the Tribunal and answer the question in the

affirmative in favour of the assessee and against the revenue.

. Reference to stand disposed of with no order as to cost.

(A.S. Aguiar, J.) **(V.C. Daga, J.)**